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Financial Distress of Industrial Firms on the Greek Banking System

Dimitris Antoniades
and
Dimitris Kouzionis

The failure or distress of a number of Greek industrial firms has hurt Greek banking — and reform of Greece's financial system is a prerequisite for industrial restructuring.

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Since the late 1970s, industrial activity in Greece has been deteriorating rapidly. An increasing number of industrial firms have experienced distress and failure.

About 40 percent of manufacturing enterprises reported losses during 1979-86. Since 1982, the manufacturing industry overall has reported a negative net income.

Because of their extensive indebtedness, the widespread distress of industrial companies has affected the soundness of Greek banks — especially the state-controlled commercial banks that account for more than 70 percent of Greek deposit and loan markets.

The financial position of Greek banks has been further undermined by large losses in non-manufacturing companies — especially construction and engineering.

Distress and failure in Greek industrial firms must be dealt with through broad macroeconomic, financial, and industrial reform. Antoniades and Kouzionis outline the main goals or targets of reform in three areas:

Macroeconomic reform

- Reducing inflation and the public deficit.

Financial reform

- Free interest rates determined by market conditions.

- Reduction of the public deficit and the public sector borrowing requirement (progress on this front is expected to be slow).

- Modernization of banking activities, particularly of portfolio management capabilities.

- Prudential regulation and supervision of banking, aimed at restoring investor confidence through more transparent activities.

- A stronger capital market, with more tradable bonds and other securities and eventual reorganization of the stock market.

Industrial restructuring

- Repayment of the foreign debt of problematic companies through the Business Reconstruction Organization (OAE).

- Repayment of domestic debt through a combination of methods.

- Systematic liquidation of nonviable companies.

- Restructuring of problematic but viable companies. Sometimes this means consolidation, but often — particularly in one large textile company — it means breaking the company up into smaller, more flexible units.

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INTRODUCTION

Since the late 1970s, a large number of Greek industrial companies have been characterized by financial distress. At the same time, the financial indicators describing the country's industrial activity have deteriorated rapidly. The financial crisis has manifested itself in the following forms:

(1) An average of about 40% of the total number of manufacturing enterprises have been reporting losses during the 1979-1986 period. At a sector level, nearly half of manufacturing sectors (9 out of 20, following the classification of the National Statistical Service) have been loss-making on average. Since 1982, Greek manufacturing industry has been reporting a negative net income on an aggregate basis.[1]

(2) New investment in fixed assets has been relatively low with obvious detrimental effects on the modernization of industrial capacity, productivity, and competitiveness. In 11 out of the 20 manufacturing sectors the net value of fixed assets (after depreciation and in constant 1979 prices) has decreased.

(3) A considerable number of firms have been reporting negative equity capital as a result of accumulated losses. A number of incentives provided by the government to encourage investment financed by equity capital has had only moderate success.

(4) Some of the biggest loss-making firms have continued operations despite serious structural problems, because of considerations unrelated to efficiency and future prospects (e.g. employment, balance of payments considerations, links with other companies, etc.).

(5) At the end of 1986 there were over 3,000 manufacturing enterprises in Greece. They had total assets of nearly GRD 2,500

[1] Some estimates suggest positive aggregate net industrial income for 1986. The apparent discrepancy is due to the sampling methods employed. In our analysis we follow the data provided by the Confederation of Greek Industries (SEB). Preliminary estimates for 1987 suggest positive net aggregate income for industry, though a considerable number of companies and some industrial sectors continued to report losses.

billion, book equity of GRD 400 billion and total debt of GRD 2,100 billion. Bank credit to the manufacturing sector amounted to GRD 1,300 billion. This compared with a book equity of less than GRD 100 billion for all Creek banks, although the banks have extensive hidden reserves in undervalued property and shareholdings in profitable companies.

(6) Because of their extensive indebtedness to the banking sector, the widespread distress of industrial companies has an adverse impact on the soundness of Greek banks, especially the major state-controlled commercial banks that account for over 70 per cent of the Greek deposit and loan markets.

(7) The Greek authorities have classified 44 manufacturing companies as "problematic". These had in 1986 total assets of GRD 220 billion, debt of GRD 350 billion and negative book equity of GRD 130 billion. Bank loans amounted to GRD 190 billion. These companies represent 15% of the total debt of manufacturing industry. However, several other companies that have been suffering losses have not been classified as "problematic" either because they were small or because they were affiliated to, and thus supported by, the main banks or because they were supported directly by the State.

(8) The financial position of Greek banks has been further undermined by large losses suffered by non-manufacturing companies, especially in the construction and engineering sectors. They also have a considerable exposure to loss-making public sector enterprises and other entities, although this is covered by state guarantees.

(9) Greek banks have taken several steps to deal with this problem. They have suspended the accrual of interest on non-performing loans, have converted some of the debt into equity, have rescheduled the remaining debt and in some cases have provided new loans. The recent recovery of corporate profitability and the strong performance of the Athens Stock Exchange have slightly reduced the intensity of the problem. Banks have been able to cover some of their losses on industrial lending from profits from their other operations. Nevertheless, much remains to be done to restructure or close down industrial companies in distress and remove their burden from the banks.

This paper discusses the extent and causes of financial distress in Greek industry and the importance of its impact on the banking system and the country's economy. It also reviews recent approaches developed to resolve the crisis and the results achieved so far.

EXTENT OF FINANCIAL DISTRESS

Brief Historical Review

The first signs of financial distress in Greece became evident during the late 1970s (effectively after 1977), when a number of big, mainly industrial, firms declared their inability to meet their due obligations. The problem was not initially considered as particularly threatening and was attributed to the two energy crises and to management inefficiencies of the specific firms.

In the early 1980s, faced with an increasing number of ailing firms, the government decided to intervene and implement new policies for industrial restructuring. In 1983, Law No. 1386/1983 was passed specifying the terms under which ailing firms would be taken over and their management transferred to the public sector. The Business Reconstruction Organization (OAE) was set up, with a capital of 5 billion GRD subscribed by the State, to handle the situation. The Organization was also given access to bank credit for any necessary additional funds.

According to the law's provisions, shareholders, major creditors, employees and other interested parties were entitled to apply for protection once a firm's insolvency could be established. Once an application was approved, the firm was officially characterized as "problematic" with the following immediate consequences:

- New management was appointed by the OAE.
- A 36-month grace period was declared, during which principal and interest payments were suspended (interest payments continued to be charged to the accounts of the firms but actual payments were postponed).
- A rehabilitation procedure was undertaken and the new Board of Directors would decide on the necessary measures. At the same time the overall viability of the firm was to be assessed.
- If the firm was considered non-viable, a liquidation process was to commence. Otherwise a restructuring program would be immediately applied, involving a compulsory increase of equity capital by the present shareholders, conversion of part of debt to equity and rescheduling of the remaining debt.

Over 250 applications were considered during 1983-87, and 46 of them were approved. Before falling under Law 1386/83 the 44 firms (excluding the two firms registered after December 1986) employed over 30,000 people and their liabilities amounted to 230.5 billion GRD[2] of which 158.9 billion to banks. Liabilities to foreign creditors (denominated in foreign currency) were estimated at about 40 billion GRD, while accumulated losses had reached the level of 110 billion GRD.

The organizational and financial structures and the market prospects for each of the firms were examined, and companies were then classified as either "viable" or "non-viable". The former group included 23 firms and the latter 21[3]. At the end of 1987 legal liquidation procedures had already started for most of the "non-viable" firms. For the "viable" firms the restructuring procedure was put in effect and they are continuing operations under new management.

While the major part of the operation is still under way, some progress has already been evidenced during the last two years. In 1986 the viable firms reported a positive aggregate operating income of 8.7 billion drachmas compared to a 2.6 billion loss in 1983. The improvement has been due to both increased net sales (145 billion GRD, 85% higher than three years earlier) and reduced costs (the gross profit margin increased from 11% to about 18%). The provisional results for 1987 show a further improvement, as the firms started enjoying the benefits of the financial restructuring. However, some of the biggest (and most important, from the creditors' point of view) companies continued to accumulate losses, suggesting that further, and possibly more drastic, action is required.

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[2]OECD - "Economic Surveys, Greece, 1986-87", p.35. Data supplied by I.Mantagos, President of OAE to "Economic Post" (01/08/88) suggest a total amount of liabilities of 173.6 billion. The difference must be attributable either to the number of firms included in the estimates and/or to the point in time chosen.

[3]Three more companies had their applications submitted after 31/12/86, so their viability had not been assessed at that time. One of them has now been effectively classified as viable, while the viability of two of the initial 23 has been reconsidered. Thus the number of viable firms stood in September 1988 at 22.

The Burden of "Problematic" Firms

The importance of the distress of "problematic" firms is shown in Table 1 which presents the basic financial indicators of Greek manufacturing industry. The problematic firms are big business units, constituting a substantial component of the country's industrial network. Thus, though representing less than 2% of the total number of industrial companies, they employ 7.2% of the total labor force (9.3% in 1981) and 11.5% of productive capacity (fixed assets). Their average capital is about seven times bigger than that of the other industrial firms.

Moreover, the problematic firms have absorbed a substantial part of total credit outstanding in the economy, both before and after the commencing of the restructuring effort (their share in total liabilities outstanding was 15.4% and 17% at the end of 1981 and 1986 respectively). To complete the picture one would also have to consider the amount of debt converted to equity (about 62 billion GRD) and other transfers of funds (from banks, the State, etc.) in the form of new equity contributions.

Considering their extensive links with other parts of Greek industry, the problematic firms probably had an adverse impact on over a quarter of the country's industry. The picture was even worse in some sectors. Had the problematic firms been left to declare bankruptcy and cease operations, the paper industry would have lost 60% of its productive capacity, 55% of its production and 75% of its exports. The respective figures for the cement industry would have been about 40-45%.

However impressive, these numbers do not capture all the dimensions of the problem because they fail to account for some even more important consequences. In an industry of relatively small size (such as the Greek industry), the failure of firms considered, by Greek standards, as "giants" entails much more harm than may be perceived at first glance. The problematic firms were supposed to be the country's leaders in the industrial development effort, paving the path for new investment ventures. They were supposed to be the "importers" of advanced technology, management techniques, and business ideas. By failing to assume such a role they contributed to a poor investment climate, destroyed the image of the Greek industry and reduced the attractiveness of the economy

TABLE 1

THE IMPORTANCE OF PROBLEMATIC FIRMS IN GREEK INDUSTRY

1981	Number of Firms	Total Assets (GRD bn)	Fixed Assets (GRD bn)	Liabi- lities (GRD bn)	Emplo- yment (000s)
Total Industry	3074	937.1	351.0	750.8	355.3
Problematic	44	116.2	71.5	115.3	33.0
% Problematic	1.4	12.4	20.4	15.4	9.3

1986	Number of Firms	Total Assets (GRD bn)	Fixed Assets (GRD bn)	Liabi- lities (GRD bn)	Emplo- yment (000s)
Total Industry	3263	2428.2	877.7	2069.8	390.3
Problematic	44	219.1	100.7	349.6	28.0
of which					
Viable	23	188.6	83.1	250.7	26.1
Non-Viable	21	30.5	17.6	98.9	1.9
% Problematic	1.3	9.0	11.5	16.9	7.2

Source: Confederation of Greek Industrialists - The Greek Industry 1987
OECD Economic Surveys - Greece 1986-87

to potential foreign investors. Moreover, through their backward and forward links to all other sectors of the economy, they created severe problems for a number of small enterprises cooperating withand depending on them. Thus, they share considerable responsibility for the unfavorable results of the Greek economy in recent years. Finally, by absorbing a great part of the credit flows to industry, they prevented the development of other, possibly more efficient, activities.

Sectoral Distribution of Distressed Companies

While Greek industry has, in general, been facing problems throughout the period examined, some manufacturing sectors were hit harder by the crisis. Table 2 summarizes the importance and experience of different sectors.

Transportation. With the automobile industry at its infant stages, the core of the sector is the ship-building industry. Performance has been particularly poor during the 1980s, with an average of 50% of the companies making losses (60% in 1985) and 9% declaring bankruptcy. From 1979 to 1986 the sector has been suffering losses, cumulatively amounting to over 40 billion GRD. There are no companies officially registered as problematic in the sector, though some of its biggest units have clearly been under financial distress for a number of years. All of the biggest four companies of the sector reported losses in 1986 (12 billion GRD in total), while three of them, accounting for about 21% of the sector's total capacity, can be safely described as ailing. The largest companies in the sector have close links with the leading banks or directly with the state.

Non-metallic minerals manufacturing. The sector includes glass, cement, ceramic and marble industries, while mining non-manufacturing industries are also usually classified here. Distressed companies account for more than a third of the sector's total productive capacity. The sector has registered the lowest average annual return on equity, although returns on total capital employed have been above average. The collapse of the Middle East markets in the early 1980s and the depression of domestic investment have contributed to the sector's difficulties. Due to a very slow rate of new equity contributions (in 1985 the aggregate equity capital of the sector was negative), and very high leverage ratios, total financial expenses increased by 10 times from 1979

TABLE 2

IMPORTANCE OF DISTRESSED SECTORS
(shares of total manufacturing)

Sector	employment	capital	production	credit
Transportation	11	9	4	-
Non-metallic minerals	6	-	6	8
Paper	2	3	2	5
Wood, cork and furniture	9	2	2	3
Basic metals and metal products	9	15	2	3
Textiles	14	14	13	15

Causes of distress:

1) Transportation:	European-wide decline of sector
2) Non-metallic minerals	Financial structure; high leverage; foreign competition
3) Paper	Over-optimistic investments in the 1970s; high leverage
4) Wood, cork and furniture	Construction-industry recession; competition from substitutes (plastic, aluminum); small scale of units
5) Basic metals and metal products	Construction-industry recession; competition from NICs; quotas imposed by the EC
6) Textiles	International competition

to 1986, while the gross margin increased by 3.5 times (not much below average). A substantial part of the sector's equity is nowowned by the banks (mainly the National Bank which is by far the largest commercial bank in the country).

The cement industry has demonstrated a substantial revival recently, mostly due to increased exports to European Community countries. New opportunities will emerge once the construction of planned major domestic projects (Athens subway, airport etc.) begins.

__The Paper Industry__. All performance indicators for the period examined have been particularly poor. From 1979 to 1986 the sector has been accumulating losses continually, cumulatively amounting to more than 45 billion GRD.

Due to heavy losses at the beginning of the 1980s the sector's equity capital has been wiped out and, since 1984, firms have been operating entirely on borrowed funds. As a result, financial expenses have grown by 10 times and about 75% of gross margins are absorbed by interest payments. During this period, new investment in fixed assets has been the lowest of all manufacturing sectors, while production has been growing at rates well above average. Probably because of the influential newspaper owners, the industry was not allowed to raise its prices to cover its high operating costs. The paper industry is the only manufacturing sector yielding a negative return on total capital employed.

__Wood, Cork and Furniture Industries__. These two "traditional" sectors have been performing poorly during the last decade, making losses continually after 1982. Nearly half of the units in the sector have been persistently making losses and an average of about 20% has been declaring bankruptcy. However, because the initial capital requirements are fairly small, new undertakings have entered the market. Nevertheless, the aggregate performance of the sector has not improved.

In both industries, investment in fixed assets has been well below average and production has been falling. The sector is not highly leveraged and financial expenses do not pose a problem to profitability. Production has been almost entirely directed to the domestic market (less than 1.5% of output is exported), while competition from imports has sharpened lately.

Basic Metal Manufacturing and Metal Products. All financial ratios have been steadily deteriorating after 1979. Due to the importance of the two sectors for the national economy, six of the biggest and worst performing units have been officially characterized as "problematic" and registered with the OAE. Today only one of them is considered to be viable. Another big non-problematic firm is under financial distress.

Despite fairly large new investments, production has been fluctuating in response to changing circumstances (a 30% drop from 1979 to 1982 was followed by a strong revival until 1985 and a new drop in 1986).

In contrast with the big size of basic metal industries, the average size of units engaged in secondary metal manufacturing is small, even by Greek standards. This does not facilitate the necessary technological and organizational modernization of operations. The aluminum manufacturing units seem to have the best prospects. The rest will require closures and/or mergers with basic metal manufacturing units aiming at integration of production.

Textiles. The textile industry is one of the most "traditional" Greek industrial sectors and, in terms of the average number of units operating between 1979-1986, the biggest manufacturing sector. After a prolonged period of rapid development, the sector faced serious financial problems for a decade or so, before exhibiting an impressive recovery in 1986 (return of capital employed in 1986 was 15.1%, the highest in manufacturing). In the meantime a number of textile industries had been under financial distress and 13 of them registered with the OAE (seven are viable). The viable firms, including the biggest problematic and fourth biggest industrial company, account for about 22% of the sector's productive capacity. Despite the general recovery of the sector, these firms continued accumulating losses in 1986, amounting to more than 7 billion GRD.

The sector's fundamental problem has been international competition. While textile exports grew by 4.3 times between 1979 and 1986, imports grew by 13.7 times. The share of output directed to foreign markets increased only slightly (from 20% to 24%), but the domestic market has been increasingly penetrated by imported products, the share of which in domestic sales increased from 7% to 23%.

CAUSES OF FINANCIAL DISTRESS

The causes of financial distress could be roughly classified in three major categories, macroeconomic, industry-specific and firm-specific.

Macroeconomic Factors

Macroeconomic instability manifested in high inflation and large public sector deficits has adversely affected Greek industry, first by raising domestic demand to unsustainable levels and then by the depressing effect of anti-inflation stabilization measures. Fluctuations in the real exchange rate, caused by high inflation and delayed discrete devaluations, undermined its international competitiveness. The vast public sector deficits also caused an increase in real interest rates, which coupled with depressed levels of domestic demand, discouraged investment.

Sector-specific causes

Many factors have had a negative impact on different sectors of Greek industry. Energy-consuming sectors such as cement and metal industries were seriously affected by the rise in energy prices in the 1970s and early 1980s, although the fall in energy prices in the mid-1980s stimulated a partial recovery of their fortunes. Highly-leveraged sectors experienced a large increase in their finance expenses following the rise in the real cost of bank loans. Sectors producing consumer goods suffered from the fall of domestic demand as well as from the reduction of trade protection that followed Greece's entry into the European Community. Sectors exporting to oil-producing countries were adversely hit by the collapse of the economies of most of these countries in the early 1980s. The performance of medium and high-technology manufacturing sectors (chemicals, mechanical and industrial equipment, transportation) suffered from lack of investment and modernization. With the exception of some individual achievements in exports, lack of the necessary technological background and experience has prevented the development of a high technology industry with good export prospects.

Greek manufacturing has failed to adjust to changing circumstances in international trade and to take advantage of the opening of the EC market. The low technology and labor-intensive industries are facing strong competition from Eastern Europe and the newly industrializing countries, while medium and high technology sectors continue to lag behind their EC competitors.

Causes specific to distressed companies

Further to the macroeconomic and sector-specific influences, there is evidence that there exist causes of financial distress which are specific to some distressed companies or to small groups of companies. Most of them relate to management (i.e. they are the outcome of erroneous decisions made at a top-management level) or to deficiencies in production, financial, and information structures.

Inadequate management. A considerable number of Greek firms does not employ professional managers. Firms are administered by their owners, who in many cases lack the appropriate background, qualifications and managerial experience. The absence of a clear separation between management and ownership is the result of the small size and family structure of a great number of enterprises.

Inadequate organizational structures. In many cases where professionals have been appointed to exercise top-management functions, responsibility lines have not been clearly drawn, resulting in the absence of management specialization and disputes at managerial level.

Incomplete or misleading accounting and information systems. The primary function of accounting in Greece has been to serve tax purposes, often with a view to evading taxes, ignoring the informational content of accounting figures. Accounting standards and disclosure requirements are underdeveloped, substantially reducing the potential for the use of accounting information for decision making. The use of other information systems has also been limited to a number of big firms. Thus, important information about consumer preferences, competition, and general market trends has been ignored. As a consequence, many companies have been surprised or even overwhelmed by developments which should have been anticipated.

Over-optimistic investments. Because of incomplete or non-existent information systems, some big investments were made without reference to competition and market conditions. There is evidence that this phenomenon has played a major role in the cases of "problematic" breweries and paper-manufacturing firms. Furthermore, because of existing regulatory rigidities (especially in the labor market), over-optimistic investments eventually resulted in under-utilization of capital and human resources, which persisted even after expectations were proved wrong.

Over-dependence on the domestic market. Trade protectionism has caused many industrial companies to depend exclusively on the domestic market. As a result, they have resisted modernization of activities, improvements in productivity and competitiveness, and attempts to expand their market shares abroad. Most of these companies came under financial distress when trade barriers were further removed following Greece's entry in the EC in 1981.

Deliberate mismanagement. There is a widespread belief in the country that some owners of big industrial units deliberately mismanaged their firms in order to take funds out of the corporate sector and, usually, out of the country. In some cases such views were also officially expressed (e.g. by the Minister of National Economy, M.Drettakis in the budget introductory report to the Parliament, 1982). The debate over the extent to which deliberate mismanagement has contributed to financial distress in industry is still going on. There is evidence that such cases related mostly to over-leveraged firms and that their owners had applied for (and in some cases were granted) large loans while preparing to declare bankruptcy. The inadequacy of bank control systems to monitor debtors (credit analysis criteria were often replaced by "personal relations") certainly bears part of the blame.

IMPACT ON THE GREEK BANKING SYSTEM

Because of the underdevelopment of the securities markets and nonbank financial intermediaries, such as life insurance companies and pension funds, the banking sector has been called upon to play a major part in the financing of the growing public sector deficits and in channelling financial resources to industry and other priority sectors. Although there has been some relaxation of credit controls in recent years, government intervention in the financial system has been very extensive and has included the imposition of large compulsory deposits at the Bank of Greece and compulsory investments in treasury bills (over 40 per cent in recent years), application of quotas on bank lending in favor of certain productive sectors and state utilities, central bank determination of the structure of interest rates and a complex system of blocking and deblocking of reserves against loans, aimed at raising the effective return to banks of low-interest loans to high priority sectors and lowering the effective return of high-interest loans to nonpriority sectors.

Extensive Controls

Being the primary financier of Greek economic activity, the banking system has played a substantial role in the country's development and the banks have usually absorbed a great part of business risk. As a result of regulated credit allocation, some activities of the private sector were given better access to bank credit than others. Thus, though commerce has been the most profitable activity for a long period, its share in total bank credit outstanding was reduced from 9.1% at the end of 1979 to 5.6% at the end of 1986, while agriculture increased its share from 16.5% to 17.3%. Manufacturing has been the activity most favored by the system although its share of total credit fell from 40.9% to 36.1% between 1979 and 1986. Reflecting the need to finance the borrowing requirements of public utilities and other public sector entities, credit to the public sector expanded from 12.5% to 24.2% of the total. The expansion of public sector borrowing adversely affected manufacturing industries although the demand for funds from industry has been subdued because of the slowdown of investment activity. In fact, distress borrowing accounted for a substantial part of new credit to industry.

Though operating in a highly regulated environment, the banks themselves bear a substantial part of the responsibility for granting loans to poorly performing companies. As a general rule, political influences replaced objective criteria in credit allocation decisions throughout the postwar period. Whether government intervention or the banks themselves are most to blame for the irrational and inefficient credit allocation remains a controversial issue. What is not controversial is that loans have been granted to companies without any reference to their business performance. The results of such a practice are always more likely to show up at times of unfavorable economic circumstances; they have been strongly felt by the banks during the late 1970s and throughout the 1980s.

The exact amount of non-performing loans is not easy to assess, both because of difficulties in classifying loans as "bad" and "non-bad", in the legal sense of the term, and because of business confidentiality. A rough estimate of the magnitude of the problem is, perhaps, reported by the banks in their annual reports (figures on "provisions for bad debt, etc."). The 1987 figures for the three major state-controlled banks and the private commercial banks are presented in Table 3. The National Bank has "provisions" amounting to GRD 39 billion or 93% of its equity base (share capital and reserves).

However, reported "provisions for bad debt" grossly understate the real magnitude of non-performing loans, as they are also affected by each bank's financial accounting policies and by regulatory requirements regarding the classification of loans. The 1987 report of the National Bank stated that it had converted non-performing loans of 122 billion drachmas into equity and had also suspended interest accrual on another 100 billion.

The big state-controlled banks have often been called to participate in efforts to rescue enterprises under financial distress, when the latter were deemed to be of primary importance to the country's economy and social welfare. The banks became involved in such operations either as a result of their financial or ownership relations with the distressed firms (for example, the ex-Andreadis group companies that came under Commercial Bank control) or acting as representatives of the State. In some cases they were directed to provide successive injections of new credit to firms performing poorly, even though the latter were about to

TABLE 3

PROVISIONS FOR BAD DEBT OF MAJOR COMMERCIAL BANKS, 1987

(in million drachmas)

	PROVISIONS	EQUITY	LOANS	P/E%	P/L%
NATIONAL	39185	42023	894409	93.25	4.38
COMMERCIAL	9714	22305	289284	43.55	3.36
IONIAN	3208	10236	144780	31.34	2.22
CREDIT	2200	7364	141496	29.88	1.55
GENERAL	936	1866	54188	50.16	1.73
ERGOBANK	845	3377	44902	25.02	1.88
TOTAL	56088	87171	1569059	64.34	3.57

Source : Annual Bank Reports (1987)

declare bankruptcy. Also, a number of big industrial firms were effectively subsidized by their creditors (banks) long before their distress was officially recognized. Though their financial performance was foretelling serious problems since the mid-1970s, they were granted new credit on social, political or other noneconomic grounds. Such firms soon became insolvent and over-indebted to the banking system at the beginning of the 1980s.

Rescue Operations

When the problem of industrial distress broke out and the Business Reconstruction Corporation (OAE) was established to cope with it, the banks were once again called to participate in and share the risk of the restructuring process. The bulk of this burden was undertaken by the National Bank, while the Commercial and Ionian Banks were also called to share. Their participation involved the conversion of part of loans to equity often at book value rather than realistic market values, extensive rescheduling of loans, including a three year postponement of debt service, and provision of new financial support.

Because of their role in supporting ailing companies, banks have undermined considerably the soundness of their investment portfolios. Table 4 presents data on the composition of the investment portfolios of the three major banks (National, Commercial and Ionian) in 1987. Their major holdings (over 5% of each Bank's own funds) are shown in Table 5.

The National Bank has clearly assumed the major role in the industrial restructuring process, as it has invested almost two times its equity capital in industrial companies, the greatest part of it in ailing ones. Its 10 biggest holdings, representing 157% of its equity base, are in major industrial firms which have been consistently making losses since the beginning of the crisis. Most of these companies have had their equity wiped out by losses or have proceeded to new equity subscriptions. The sole (or main) subscriber has been the National Bank. In addition, the Bank holds 65.6 billion drachmas in bonds issued by the OAE and guaranteed by the State, as part of the problematic firms' debt restructuring.

The Commercial and Ionian Bank (both belonging to the Commercial Bank Group) have also taken some, though much smaller, part in industrial restructuring. The most important burden of the

TABLE 4

OBLIGATIONS OF PROBLEMATIC FIRMS, 1986

	Viable	Non-Viable	Total
To Banks			
(a) "Old" i.e loans granted before OAE assumed management	91.4	62.7	154.1
(b) "New"	32.2	0.5	32.7
Total	123.6	63.2	186.8
To the State and Insurance Funds			
(a) "Old"	10.0	9.5	19.5
(b) "New"	5.3	0.9	6.2
To OAE	41.6	13.9	55.3
Total	56.9	24.3	81.0
Total Outstanding	180.5	87.5	267.8
of which "Old"	101.4	72.5	173.6
"New"	79.1	15.0	94.2

Source: Interview of President of OAE "Economic Post", August 11, 1988).

group is the "Elefsina Ship-Building Company", which is not officially registered as "problematic" but, because of the size of its losses and its needs for new capital, poses a serious threat to the well-being of the group.

Despite the immensity of the problem banks have been able so far to cover some of their losses on industrial lending from profits from their other operations. The National Bank was able in 1987 to realize capital gains of GRD 17 billion on some of its various shareholdings. The recovery of industrial profitability and the strong performance of the Athens Stock Exchange have also contributed to a slight alleviation of the seriousness of the problem. However, the banks continue to have non-performing loans well in excess of their equity.

TABLE 5

EQUITY HOLDINGS OF MAJOR GREEK COMMERCIAL BANKS, 1987

A. NATIONAL BANK OF GREECE

EQUITY CAPITAL : 42023 MILLION DRS

Holdings in Companies	Number of Companies	Holdings (GRD mn)	% of NBG Equity	% of Total Holdings
1. Non-Industrial				
Banks	13	5531	13.16	5.29
Insurance	3	3144	7.48	3.01
Holding	2	5257	12.51	5.03
Real Estate	3	31	0.07	0.03
Tourism	6	7743	18.43	7.41
Commerce, etc	11	5649	13.44	5.41
Sub-Total	38	27355	65.10	26.17
2. Industrial				
Food and Beverages	6	1665	3.96	1.59
Textile	13	33113	78.80	31.68
Paper Industries	5	17939	42.69	17.17
Chemicals	8	5305	12.62	5.08
Non-metal. Minerals	4	4447	10.58	4.26
Electrical Appl.	3	4432	10.55	4.24
Metal Industries	15	8823	21.00	8.44
Other Industrial	9	1430	3.40	1.37
Sub-Total	63	77154	183.60	73.83
Total Holdings	101	104509	248.69	100.00
of which				
"Problematic"	20	65902	156.82	63.06
Industrial	18	65364	155.54	62.54
Non-Industrial	2	538	1.28	0.51

B. COMMERCIAL BANK OF GREECE

EQUITY CAPITAL : 22305 MILLION DRS

Holdings in Companies	Number of Companies	Holdings (GRD mn)	% of NBG Equity	% of Total Holdings
1. Non-Industrial				
Banks	11	3506	15.72	17.28
Insurance	4	3115	13.97	15.35
Holding	1	11	0.05	0.05
Other	4	316	1.42	1.56
Sub-Total	20	6948	31.15	34.24
Industrial	na	13343	59.82	65.76
Total Holdings	na	20291	90.97	100.00
of which				
"Problematic"	3	2021	9.06	9.96
Industrial	3	2021	9.06	9.96
Non-Industrial	0	0	0	0

C. IONIAN BANK OF GREECE

EQUITY CAPITAL : 10236 MILLION DRS

Holdings in Companies	Number of Companies	Holdings (GRD mn)	% of NBG Equity	% of Total Holdings
1. Non-Industrial				
Financial	10	165	1.61	5.09
Other	3	1434	14.01	44.26
Sub-Total	13	1599	15.62	49.35
Industrial	16	1641	16.03	50.65
Total Holdings	29	3240	31.65	100.00
of which				
"Problematic"	3	174	1.70	5.37
Industrial	3	174	1.70	5.37
Non-Industrial	0	0	0	0

TABLE 6

MAJOR INDUSTRIAL HOLDINGS

(Holdings over 5% of the Bank's Equity Base)

A. NATIONAL BANK OF GREECE

COMPANY	SECTOR	PROBLEMATIC	% CO'S EQUITY	%BANK EQUITY	TOTAL LOSSES 83-87 (GRD bn)
PIRAIKI - PATRAIKI	TEXTILES	YES	30.0	63.2	-22.0
S. MICHAILIDIS	TEXTILES	YES	46.8	5.4	-3.2
MEL	PAPER	YES	27.4	8.1	-8.0
THESSALIKI	PAPER	YES	29.9	8.7	-9.3
ATHENAIKI	PAPER	YES	33.9	24.9	-15.4
PYRKAL	METAL	YES	29.0	10.0	-2.6
HERACLES	CEMENT	YES	9.7	9.6	-9.2
ELINTA	ELECTRICAL	YES	28.9	10.0	-7.2
SKALISTIRIS GROUP	MINERALS	YES	25.0	12.2	-17.4
EPAS	WOOD	YES	36.0	5.2	-5.7
TOTAL				157.3	-99.9

B. COMMERCIAL BANK OF GREECE

COMPANY	SECTOR	PROBLEMATIC	% CO'S EQUITY	%BANK EQUITY	TOTAL LOSSES 83-87 (GRD bn)
PHOSPHORIC FERT.	CHEMICAL	NO	62.2	8.3	0.8
ELEFSINA SHIPBDNG	TRANS/TION	NO	65.0	35.9	-10.0
HERACLES	CEMENT	YES	5.7	7.9	-9.2
TOTAL				52.1	-18.4

C. IONIAN BANK OF GREECE

COMPANY	SECTOR	PROBLEMATIC	% CO'S EQUITY	%BANK EQUITY	TOTAL LOSSES 83-87 (GRD bn)
PHOSPHORIC FERT.	CHEMICAL	NO	27.91	8.13	0.8
ELEFSINA SHIPBDNG	TRANS/TION	NO	9.50	3.31	-10.0
TOTAL				11.44	-9.2

Source : Annual Bank reports (1987)

PROSPECTS FOR INDUSTRIAL AND FINANCIAL RESTRUCTURING

Financial distress in industry has been the consequence of macroeconomic, financial and management factors as well as of interactions among them. A successful resolution of the accumulated problems requires action in all fields of economic and business activity in the country.

At a macroeconomic level, the two major problems are inflation and the public sector deficits. Reducing inflation rates to levels similar to those of other EC countries is a basic pre-condition for eliminating a number of problems in the industrial and financial system and enhancing the economy's dynamism and competitiveness. The two-year stabilization program made some progress towards this direction. Further reduction will depend heavily on the effectiveness of policies designed to contain the growing deficits of the public sector.

Financial Reform

It is widely accepted that a major reform of the financial system is a necessary precondition for industrial restructuring. Financial system inefficiencies have been a major factor blocking efforts to restore industrial sector efficiency. The 1987 "Report for the Reform and Modernization of the Financial and Banking System" suggested a number of measures necessary for promoting financial sector efficiency. Since then, there has been significant progress in implementing several of the Report's recommendations. The main targets of the reform are outlined below:

Interest rates. The ultimate target is completely free interest rates, determined by market conditions. Interest rate subsidies for specific activities (e.g. agriculture) will continue for some time, but their cost will be transferred to the government budget. The implementation of these policies is under way and is expected to be completed by the end of 1990.

Public sector borrowing requirement. The State is expected to start applying to the primary market to finance its capital needs (open market operations). All administrative regulations previously used to serve this purpose are to be gradually abolished. The issue of long-term (3-15 years) government bonds is primarily designed to serve this process. However, both the government budget deficit and the borrowing requirement of the extended public sector need to be reduced, though progress on this front is likely to be slow.

Modernization of banking activities. The banking system has to reform its organizational structures and modernize its activities in order to facilitate economic and industrial development, as it is (and will remain for long) the primary financier of business activity and to survive competition from other EC banks and banks of third countries, as a result of the expected "completion of the EC internal market" by 1992.

As part of this modernization drive, banks are expected to strengthen their portfolio management capabilities. Most bank portfolio holdings have been the result of exceptional circumstances rather than of deliberate portfolio decisions by the banks. Releasing banks from the responsibility of managing such holdings (non-profitable in most cases) is the objective of a plan designed to transfer them to specialized holding companies. These provisions refer to shareholdings in (mostly) industrial companies, while participations in credit institutions will remain under the direct control of banks.

Prudential regulation and supervision. The role of the Bank of Greece in controlling banking activity will be enhanced and new regulations regarding accounting disclosures and the provision of information to investors are to be established. At the same time provisions regarding the appraisal of solvency and liquidity control of banks are expected to be included in the final draft of the EC Second Banking Directive, to be completed by the end of 1989. All the above regulations aim at securing the transparency of banking activities and reinforcing investor confidence in financial instruments issued by banks.

Promoting the role of the securities market. One of the main targets of financial reform is to enhance the role of the capital market. A series of measures have been proposed in order to reorganize the stock-market, to increase the supply and stimulate demand for securities. On the supply side, these include increasing the issue of government bonds through the capital market, introducing new tradable securities, such as commercial paper and certificates of deposit, and increasing the supply of corporate and bank bonds, especially bonds of long-term investment and mortgage banks. On the demand side, the proposed changes include amending the existing tax legislation to establish a neutral tax system for different financial assets, introducing incentives to insurance companies and funds to assume the role of institutional investors and incentives for foreign investor participation in stock market operations.

There is also new legislation regarding the reorganization of stock market operations. Further to those provisions, the establishment of an over-the-counter market and, at a later stage, a new stock-exchange in Salonica are under consideration.

Industrial Restructuring

Regarding the restructuring of industry the State and the banks have a prominent role to play in resolving the issue of "problematic" and other distressed firms and assisting industry to modernize its capacity. Many of the problems encountered by "problematic" companies are of a financial nature. The financial restructuring plan that has been implemented so far incorporates the following provisions:

- Debt to foreign banks is to be repaid by the Business Reconstruction Organization (OAE), whose representatives have already reached an agreement with a consortium of banks in London. The contract provides for a new loan of US$29.5 million at a rate of 0.5 points over LIBOR and a 5-year grace period. The major part of the amount (about 24 million) will be treated as a loan granted by OAE to the distressed firms and repaid within 8 years, while the rest will be converted to equity owned by the Organization.
- Similar settlements have been made regarding the debt of the problematic firms to foreign suppliers and the debt of Greek banks to foreign banks for loans taken on behalf of problematic firms. About US$50 million will be repaid in this manner.
- Debt to domestic creditors (suppliers, public utilities, insurance funds, etc.) is to be repaid by a combination of methods, such as cash provided by OAE (for 25% of total debt) shares, bonds issued by OAE and guaranteed by the State, etc. Similar provisions are applied on debt to Greek banks.

Further to the above settlements, new subscriptions to the equity capital of the profitable problematic firms are expected, where necessary. For the six firms listed in the Athens Stock Exchange, new shares will be sold through the capital market, while the procedure for registering another three firms is under way. The ultimate target is to relieve viable problematic firms from their old financial burdens and ensure both the appropriate level of capital and the most efficient capital structure for their future welfare. Whether the ownership of viable firms will be transferred to the private sector is still not clear. It is probable that some of them (those considered to be of strategic importance) will remain under direct state control.

Regarding the non-viable firms, the procedure for their liquidation has advanced during the last year. Three firms have already been sold through an auction-sale system. The liquidation of the rest of the non-viable firms is progressing and is expected to be completed soon for most of them.

As part of the rehabilitation process many firms need a restructuring of existing operations. Being under financial distress for a number of years, "problematic" companies have not made adequate investments in new machinery and therefore their capacity is obsolete. Promoting efficiency and reducing production costs requires, in some cases, extensive replacement of machinery and reconsideration of existing production structures. In some of the biggest problematic firms, parts of their operations could become profitable while the rest have poor prospects. Reducing the production of some products or even completely abandoning them may be the best solution in some cases.

Greater attention needs also to be paid to the organizational and management structures. There are cases where size has been a barrier to development. While the average size of Greek manufacturing companies is small and mergers seem to be a suitable solution to improve profitability, the problematic firms are typically big, in many cases the biggest in their sector. Size might thus be a problem in some cases and splitting operations the appropriate action. In at least one case (the biggest textile industry in the country) this solution is being implemented, aimed at promoting flexibility and specialization of the emerging smaller units. Irrespective of other appropriate changes, the appointment of professional management is a necessary condition for ensuring the future efficient administration of viable problematic firms.

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